PRIVATE MARKET LIQUIDITY: ILLOGICAL OR INSPIRED?

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CONTENTS

HIGHLIGHTS

A confluence of factors is expanding access, bringing more investors and injecting additional liquidity to private markets. Here is what GPs and LPs had to say about emerging trends in this market:

Role of Private Markets

- GPs are twice as likely as LPs to say that private markets provide excellent **portfolio diversification**.
- The illiquidity premium is real, but it may shrink as **liquidity options** multiply in coming years.
- Their usefulness in portfolio construction has regulators lowering barriers and **expanding access**.

Retail Access

- 8 out of 10 GPs say **non-accredited individuals** should be able to invest in private markets.
- Widespread scepticism around the future of private market **mutual funds and ETFs** is fading.
- A variety of new funds are packaging private market assets for retail financial advisors and **retirement plans**.

Secondaries

- Half of all survey participants will **buy or sell secondaries** this year... a huge jump from 2015.
- Manager and investor views on **valuations** are increasingly aligned.
- No longer stigmatised, secondaries are being used to **actively manage** portfolios.
- A **lack of transparency** is preventing an even wider embrace of secondaries.

The Future

- **Intermediary roles** are evolving to include transaction structuring and negotiations.
- **ESG and D&I** are causing investors to restructure private market portfolios.
- The jury is out on the long-term impact of **blockchain** technology.
- Exchanges and **trading platforms** are widely expected to gain market share.

SAME SAME BUT **DIFFERENT**

The global spread of COVID-19 spurred interest in the idea of a "new normal" during the second quarter of 2020 as people locked down their lives and adjusted to remote work, school, and entertainment.[1] The financial markets were hardly immune. Public markets reacted with sharp volatility while the pandemic cast a sudden chill over the red-hot private equity business. Transaction volume fell significantly in the second quarter, and private equity managers (General Partners or GPs) turned their attention to tending existing portfolio companies. Over the summer, investors (Limited Partners or LPs) were left in limbo to speculate on how it would all shake out.

It is a market in transition, with the final contours yet to be determined...

As the uncertainty ebbed, life returned to the moribund industry. Deal value soared in Q3, very nearly doubling from the same period a year earlier. The situation stabilised further in Q4, as strong activity in the Asia Pacific region resulted in aggregate global deal value of approximately US$536 billion for the year 2020, just between the global deal values for the two preceding years.[2] The new normal—it seemed—would be much like the old one, albeit with more Zoom calls.

Or would it? Anybody passing through Southeast Asia has heard the expression "same same but different." It may sound nonsensical to the uninitiated but these four words are capable of nuanced meaning.[3] Purposefully vague, this phrase can prove surprisingly useful, conveniently allowing the user to brush off arguments and move conversations along. It can also be used to highlight—rather than obscure—subtle differences.

Any conversation about liquidity in private markets tends to focus on the secondary market. Although they are an important cog and unquestionably add liquidity to private markets, secondaries are a familiar piece of a much grander puzzle. New exchanges and platforms are proving popular. Retail access is expanding. Blockchain is coming. This is a market in transition, with the final contours yet to be determined.

Private markets may look familiar in another 10 years, but any resemblance to the past is likely to be superficial. Beneath the surface, the industry is busily adapting its business models and operational infrastructure to capitalise on multi-faceted opportunities presenting themselves as the business becomes more liquid. Same same. But different.

SEI partnered with Preqin and ANZU Research in late 2020 to survey GPs and LPs on trends in private market investments.

Designed as a follow-up to an earlier survey conducted in 2014–2015, this year's survey placed particular emphasis on investor access, liquidity, transparency, and technology.

Data from online surveys was supplemented by insights gathered via in-depth personal interviews. More than 400 fund managers and investors took part in this research. We would like to extend a heartfelt thank you to all who participated.

FINDINGS

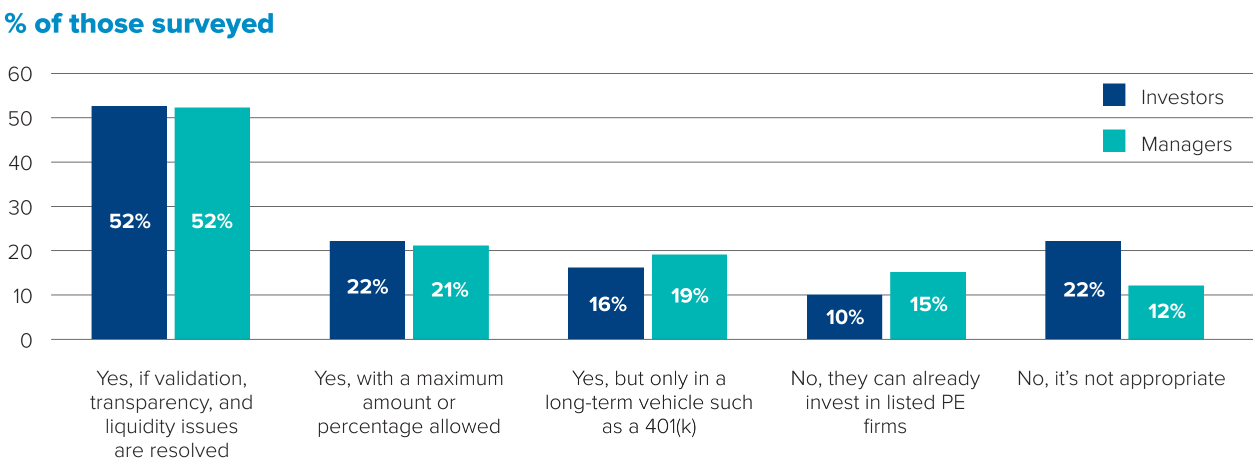
Retail investors, mind the gap

In search of higher returns and superior portfolio diversification, retail investors are actively seeking exposure to assets that have been off limits to them in the past. Regulators have traditionally been quick to articulate concerns over suitability, but democratisation may prove to be unstoppable. The US Securities and Exchange Commission (SEC) has already expanded its definition of accredited investors and discussed the removal of guidance that limits closed-end funds with large quantities of illiquid assets.[4] Additionally, the US Department of Labor has issued guidance that retirement plan advisors could make private equity investments available to individuals without violating their fiduciary duty.

There is widespread support within the industry for broader access to private securities, with almost 8 out of 10 asset managers surveyed saying that non-accredited individuals should be able to invest in private markets. Despite some hesitancy, nearly as many (72%) of LPs agree (Figure 1). Both groups are remarkably in sync, going so far as to agree on certain caveats to wider access. About one in five thinks exposures should be capped at a certain amount or percentage. A slightly smaller group takes a sterner view, suggesting that access should be limited to long-term holdings such as retirement plans. A majority, however, see no problem with retail access as long as fundamental issues such as valuation, transparency, and liquidity are worked out in advance.

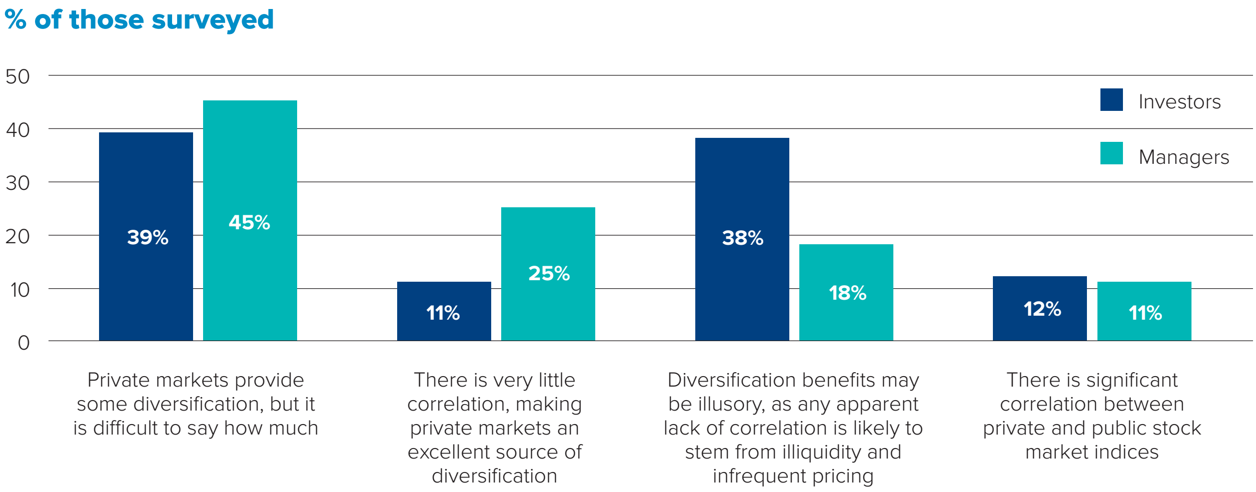
Major industry names such as Carlyle Group, Hamilton Lane, and KKR have accepted the challenge and rolled out a number of US '40 Act funds focused on private markets. Some of these are tender-offer funds, which allow managers to limit the amount and timing of redemptions. Others, such as the Private Shares Fund (formerly known as the SharesPost 100 Fund) from Liberty Street Advisors, are interval funds that feature daily pricing and minimum investments as low as US$2,500 from any individual, regardless of accreditation. Crossover mutual funds, while not common, aren't new—as of 2018, they had already collected US$48 billion of assets, according to iCapital.[5]

FIGURE 1. Do you think retail (i.e. non-accredited) investors should have more access to private markets?



Note: More than one selection allowed
Source: 2020 SEI Private Market Liquidity Survey

FIGURE 2. Which of the following best reflects your view on the correlation of private investments to public stock market indices?



Source: 2020 SEI Private Market Liquidity Survey

Because the working definition of "active management" is evolving to incorporate a wider range of securities and vehicles, this trend will almost certainly gain steam in the future. The promise of improved portfolio diversification has been a major driver of interest in private markets for retail advisors, particularly in the aftermath of the global financial crisis when so many markets crashed simultaneously. There is still a strong case to be made for diversification, as evidenced by the fact that only 1 in 10 survey participants say there is significant correlation between private and public markets (Figure 2).

The vast majority of industry insiders recognise at least some degree of benefit, but managers are more than twice as likely to claim that private markets provide an "excellent" source of diversification (Figure 2). Investors are more circumspect, with 38% saying the advantage may be less significant than commonly believed, thanks to infrequent pricing and low liquidity. Only 18% of managers voice similar concerns. Further democratisation of private market investments will inevitably be accompanied by greater transparency, attribution, and performance analysis. The true value of diversifying portfolios with private markets will come into sharper focus as research accrues.

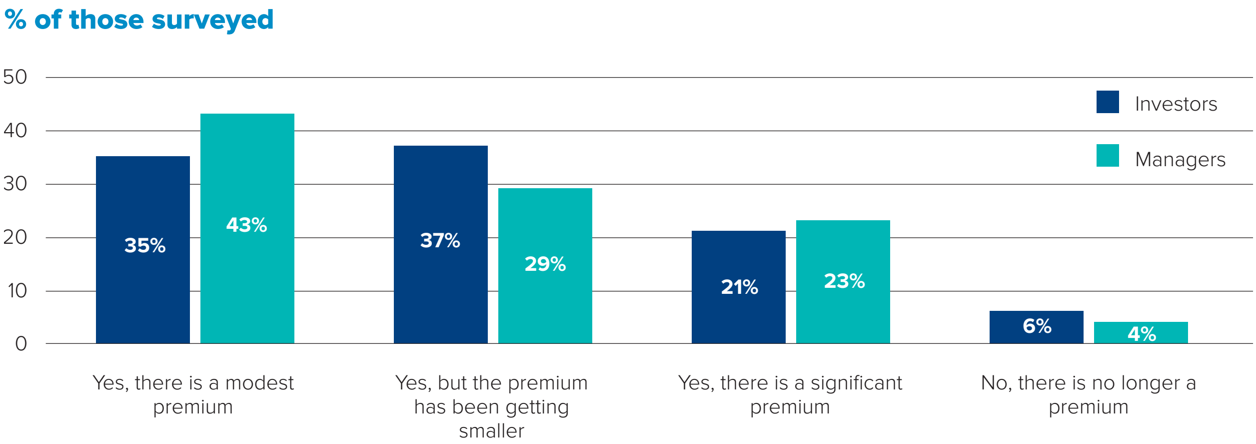
Is the premium sustainable?

Managing risk and tempering volatility through diversification is hardly the only appeal of private market investments, of course. Private securities are often sought after for the potential for higher returns in return for long lock-up periods. Most professionals believe this to be true: The number of survey respondents who claim there is no longer an illiquidity premium is in the low single digits (Figure 3). The largest group is comprised of those seeing a modest premium. Investors are more likely than managers to argue that the premium is shrinking.

> **"Attractive risk premiums exist … and it would be a positive evolution to broaden access to these vehicles."**
>
> **Scott Baskind,**
> **Head of Global Private Credit, Invesco**

Current market participants accept the lack of liquidity as a fact of life, but the arrival of retail investors is inevitably testing this assumption. Existing vehicles and structures don't pose

FIGURE 3. Do you think there is a sustainable illiquidity premium for investors in private capital investments?



Source: 2020 SEI Private Market Liquidity Survey

a problem for endowments with long (or even evergreen) investment horizons, but they are less likely to be suitable for investors who need more dependable cash flows. This is of course true of asset classes beyond private equity as well. Venture capital, real estate, infrastructure, and private debt have all traditionally fallen on the less liquid end of the liquidity spectrum. As Scott Baskind, head of global private credit at Invesco, points out, "...we continue to feel that attractive risk premiums exist in the less liquid forms of private credit and believe it would be a positive evolution to broaden access to these vehicles, but do recognise the importance of client education, transparency, and liquidity in getting that right."

The asset management industry abhors a vacuum, so solutions are emerging to bridge this gap. Traditional models still dominate, but there are signs of change. A reinvigorated secondaries market is being bolstered by the arrival of noteworthy new participants. Exchanges such as Nasdaq Private Market and others are facilitating transactions across multiple types of securities.

Half of all managers and investors indicate they will participate in the secondary market in 2021.

Networked platforms such as CAIS and iCapital are easing access for advisors. Private equity is even finding its way into 401(k) plans and packaged investment vehicles. The premium is still very real, but it's likely to shrink as liquidity options multiply in coming years.

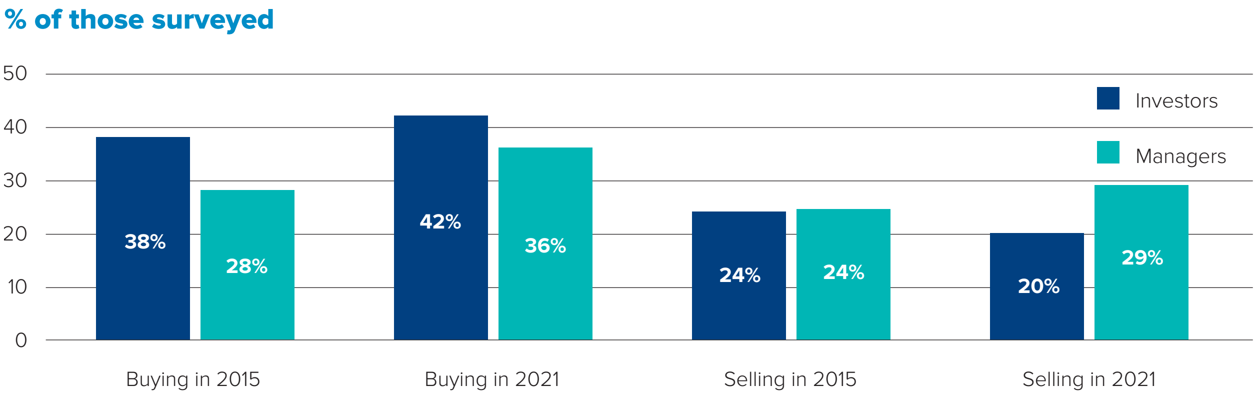
Secondaries: no longer second fiddle

Rising participation in the secondary market

Vividly demonstrating how the cloistered world of private markets is opening up, half of all managers and investors surveyed indicate they will participate in the secondary market in 2021. This is dramatically higher than our survey six years ago, when only 28% of managers and 38% of investors planned to buy or sell in the secondary market. This finding is corroborated by a Coller Capital survey from mid-2020, which revealed that more than 50% of LPs planned to buy or sell secondaries.[6] Purchases are more common than divestments, with more than 40% of all survey participants planning to buy secondaries in 2021, and only 24% planning to sell.

Change is visible across the industry but it is most evident among managers, where there was an eight-point rise in the number planning to buy

FIGURE 4. Secondary market activity: 2015 vs. 2021



Source: 2020 SEI Private Market Liquidity Survey, 2014 SEI Private Equity Liquidity Survey

secondaries and a five-point rise among the number of those selling (Figure 4). This uptick in sellers reflects growing interest in continuation funds, which are seen as a win-win for investors and managers. Brian Mooney, managing director and co-head of GP-led secondaries at Portfolio Advisors explains: "From an existing limited partner's perspective, a successful outcome typically achieves a fair, market-driven price for those investors that wish to sell and an attractive option to 'roll' should they prefer to retain their exposure to the asset and sponsor... For general partners, there are myriad goals that continuation transactions can achieve. Most importantly, these transactions provide GPs with additional time and often additional capital to maximise value of the subject asset(s) while delivering optionality to existing LPs."

"LPs are increasingly active in the secondary market, primarily for portfolio management reasons."

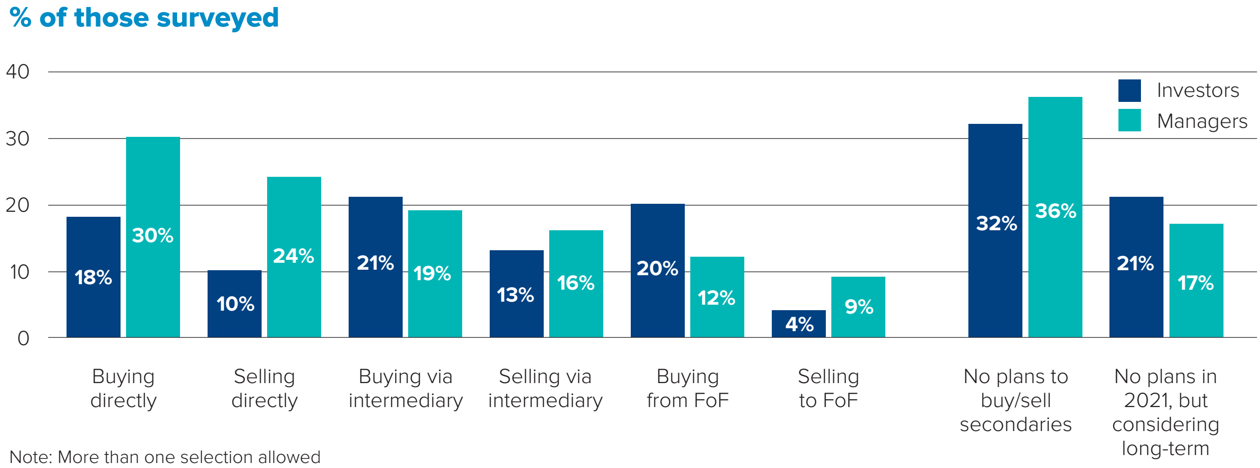
David Lowery,
Head of Research Insights, Preqin

Aided by a growing number of transaction venues, investors welcome the opportunity to access liquidity more conveniently and manage their portfolios more actively. This is especially true in the emerging post-COVID world, where assets in so-called tail-end funds have ballooned.[7] According to David Lowery, head of Research Insights at Preqin, "LPs are increasingly active in the secondary market, primarily for portfolio management reasons such as active management and portfolio rebalancing."

More confident about navigating the less familiar world of secondaries, managers are far more likely than investors to buy or sell directly (Figure 5). Investors are distinctly more interested in buying secondaries than selling them, and they prefer to do so via intermediaries or funds of funds. Overall, the secondaries market is becoming much more intermediated compared with six years ago, when direct purchases and sales easily outpaced other methods.

Only a third of all participants say they plan to avoid the secondary market indefinitely. One in five does not plan to participate in 2021, but suggest they are open to buying or selling secondaries further down the road. Portfolio Advisors' Mooney says, "We expect the LP secondary market to continue to grow as more institutional investors adopt these

FIGURE 5. Do you plan to participate in the secondary market in 2021?



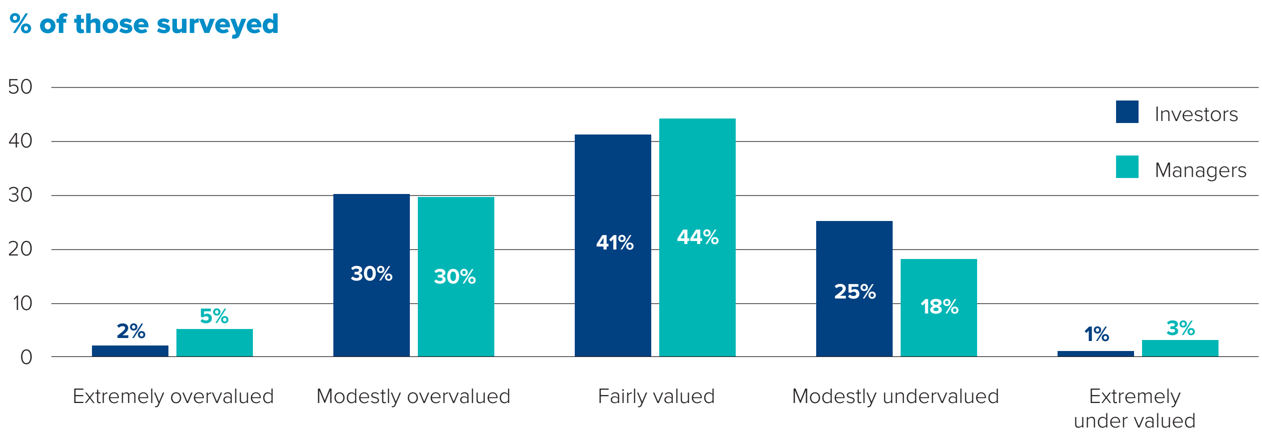
Note: More than one selection allowed
Source: 2020 SEI Private Market Liquidity Survey

transactions as a portfolio management tool. However, we also believe that GP-led transaction volume will outpace LP secondaries." He goes on to note that "while the GP-led secondary market was originally defined by older assets and 'zombie' funds, volume and usage of continuation transactions is now dominated by brand-name sponsors, which gives the market true institutional credibility and staying power."

Current valuations for secondaries

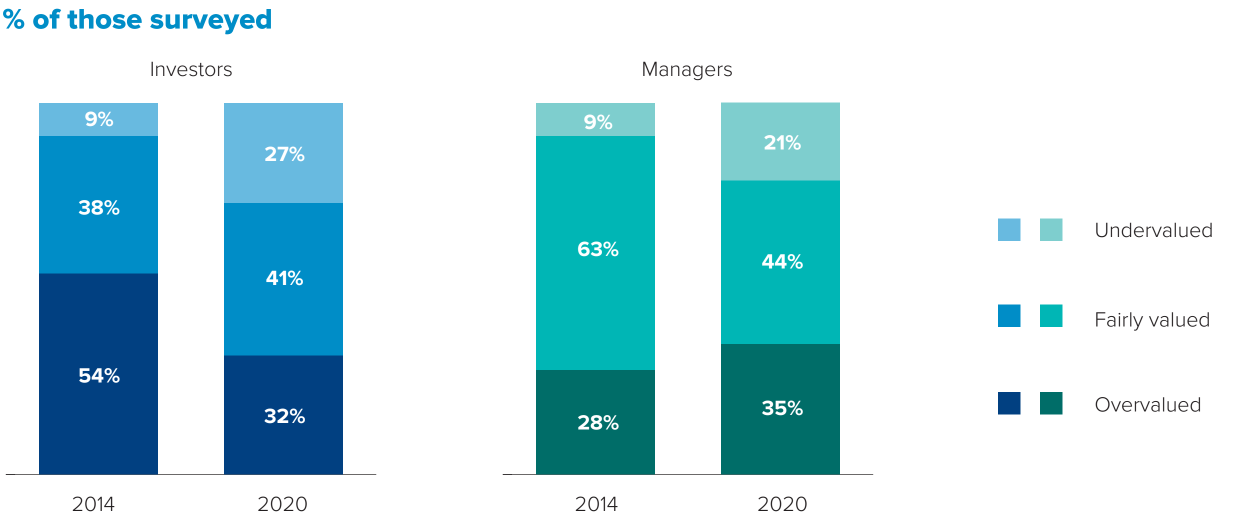
COVID temporarily deflated private market activity, and the secondary market is not exempt. If nothing else, it was an opportunity for the market to cool down and reset. By the end of 2020, few investors or managers think valuations are extremely out of line (Figure 6). Although many think the market is fairly valued, the rest are skewed toward those who consider the market for secondaries to be somewhat overvalued. It is worth noting that, both managers and investors are more likely than they were six years ago to say that secondaries are undervalued (Figure 7). Even more striking is how much more aligned GPs and LPs are in 2020. Thanks to the transparency ushered in by deal volume and data access, perceptions that were vastly different in 2015 are virtually indistinguishable today.

FIGURE 6. What is your view of current valuations in the secondaries market?



Source: 2020 SEI Private Market Liquidity Survey

FIGURE 7. Comparison of Secondary Market Valuations: 2014 vs. 2020



Source: 2020 SEI Private Market Liquidity Survey, 2014 SEI Private Equity Liquidity Survey

Role of third parties in the secondaries market

As the appeal of secondaries continues to spread, deal making continues to evolve. Alternatives platforms from entities such as Nasdaq and iCapital are vying for mind- and market share with traditional go-betweens such as Cogent Partners and Campbell Lutyens. With the number and variety of intermediaries mounting, their roles are evolving beyond the identification of buyers and sellers to include transaction structuring, data room management, and negotiations.

Investors are more inclined than managers to value the participation of third parties in the secondaries process.

Investors are more inclined to value the participation of third parties in the secondaries process, saying they are particularly valuable when it comes to matchmaking and pricing (Figure 8). Managers are more sanguine, especially in negotiating or pricing deals, with one out of three saying third parties are simply unimportant.

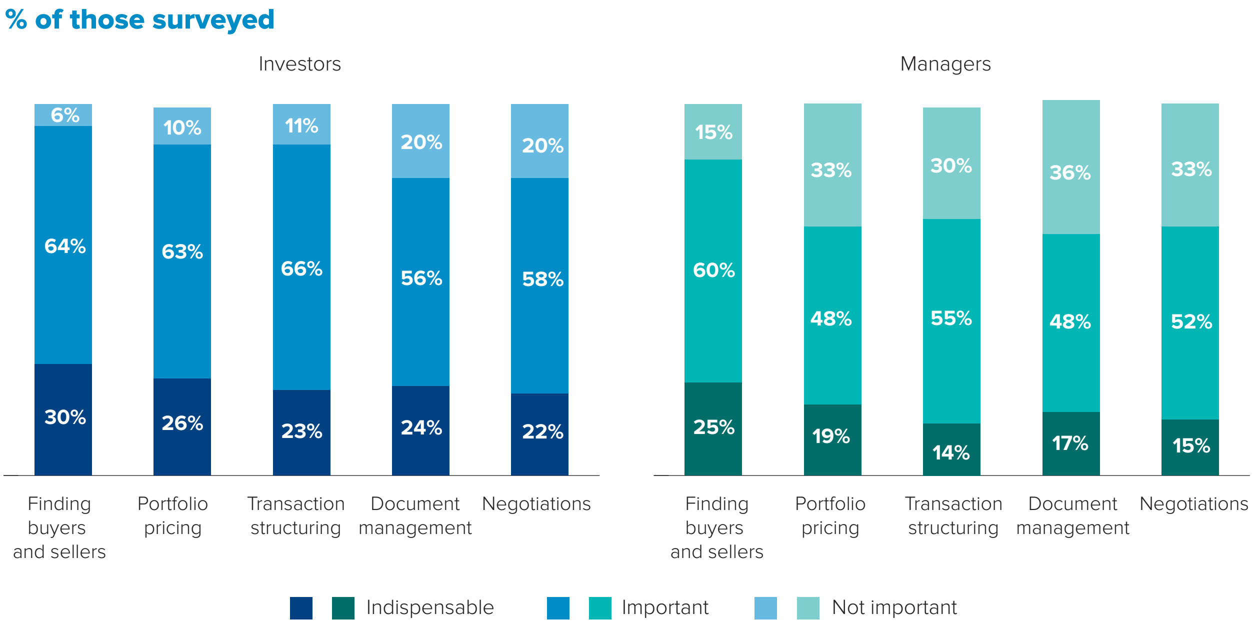
A reputation relegated to history

It was not long ago that many looked askance at secondaries, viewing them as a somehow less reputable version of the primary market for private securities. Some of this was rooted in the idea that a sale on the secondary market indicated a seller in distress. Nowadays, secondary transactions are more likely to reflect investors taking a more active approach to managing their portfolios.[8]

Attitudes have shifted over time, and the recent introduction of dedicated secondaries funds by industry titans has highlighted the mainstreaming of this once decidedly ancillary market. BlackRock raised US$3 billion to invest in private equity secondaries in early 2021, noting at the announcement that “We believe that the secondary market is poised for strong future growth as limited partners and general partners alike seek more creative ways to access liquidity and realise value.”[9]

Nowadays, secondary transactions are more likely to reflect investors taking a more active approach.

FIGURE 8. How important are third parties for each of the following in the secondary market?



Source: 2020 SEI Private Market Liquidity Survey

Other notable firms like TPG and Ares established footholds with acquisitions, and Apollo Global Management is rumoured to be planning its own entry into the secondaries market.[10]

More than half of all survey respondents say there are no longer any taboos associated with selling secondaries (Figure 9); this figure is up five percentage points from our 2014 survey. There are holdouts: One manager in the survey characterised the secondary market as consisting of "unsuccessful funds or unhappy investors," and a few investors worried that a secondary sale could hint at underlying problems. Most survey participants, however, are likely to find little or no stigma remaining. One noted that the motivation for a deal might need to be explained, but others insisted that the market had moved on and secondaries are widely seen as a standard portfolio management tool.

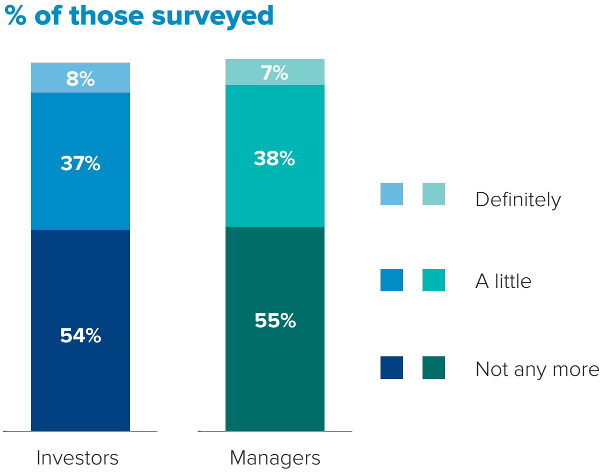
The net result of this swing in perspective is more liquidity for industry veterans as well as for those adding private market assets to their portfolios for the first time. Liquidity may not be the ultimate objective; instead, it can be a means to an end. According to iCapital, "Secondary transactions can help investors reduce their number of general partner relationships, meet regulatory changes that require a reduction in private market exposure, and address asset allocation shifts at the direction of their investment teams."[11]

> **"PE is usually 10 to 15 years behind the public markets in the way information is handled."**
>
> **Julien Gervaz,**
> **CEO, Palico**

Transparency in the secondaries market

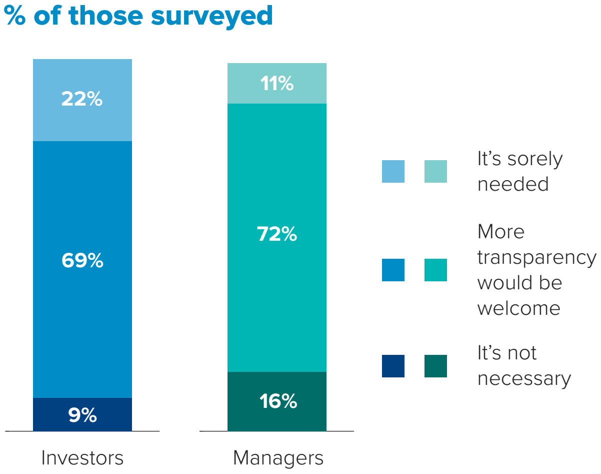
A key hurdle in the way of an even wider embrace of secondaries is the paucity of transparency. There is widespread agreement that more clarity would benefit the secondaries market. Investors in particularly are eager for more transparency, with fewer than 1 in 10 saying they didn't think it was necessary (Figure 10).

FIGURE 9. Do you think there is any taboo associated with selling assets on the secondary market?



Source: 2020 SEI Private Market Liquidity Survey

FIGURE 10. Do you think more transparency is needed in the secondary market, particularly as it grows?



Source: 2020 SEI Private Market Liquidity Survey

Recognising its pivotal role, many are rushing in to address this pent-up demand. Infomediaries and industry media promote the flow of information. Markets and exchanges create feedback loops that amplify transparency. Data and service platforms are making it progressively easier for managers to provide greater access and insights to investors.

In an interview with Private Equity Wire, Julien Gervaz, CEO of secondaries platform Palico, points out that private markets have a lot of ground to make up: "If you look at what has been done on the public side in the '80s, standardise(d) trading information and the logistics associated to it made everything easier. PE is usually 10 to 15 years behind the public markets in the way information is handled."[12]

The future of private markets

How transactions will evolve

Wider access and louder demands for transparency mean the nature of transacting in private markets will change. Investors are already asking questions that extend far beyond their traditional focus on operations, process, and controls. Additional lines of questioning are likely to cover topics ranging from valuations and diversity to the environment, technology, and cybersecurity.[13] The extra diligence is often aimed at fund CFOs, creating a potentially unsustainably high workload.

Data and service platforms are making it progressively easier for managers to provide greater access and insights to investors.

Environmental, social, and governance (ESG) issues are becoming more prominent, leaving managers scrambling to adapt and creating the potential for turnover as investors attempt to restructure portfolios to better align with their values. With investors actively seeking ESG screens and a more diverse slate of portfolio managers, GPs are being forced to step up. Invesco's Scott Baskind notes that "our global institutional investor base increasingly is demanding ESG to be fully integrated into private asset classes. From our perspective, ESG is a central tenet to our credit risk evaluation and an area we moved on years ago to develop a proprietary framework to appropriately underwrite the risk."

Brian Bank, of the Investment Funds Group at Kirkland & Ellis, says his firm is now seeing more strategies around the Social and Governance side of ESG. He goes on to caution that "ESG is still somewhat of a challenge in practice. There need to be clearer, more succinct definitions by GPs so that LPs know where to bucket their allocations accordingly in terms of addressing ESG and incorporating it into their investment strategies."

Lest this trend be dismissed as a fringe development that can safely be discounted or given lip service, it is worth considering the broader context. Taking a more holistic view toward the sustainability of assets or strategies, investors are looking beyond ESG to also ask managers about diversity and inclusion (D&I) initiatives. These queries may be aimed at establishing common philosophical ground, but they also focus on more tangible operational details like formal written guidelines. It is only a matter of time before service providers will be expected to provide similar information as part of due diligence, further enhancing transparency and setting the stage for additional liquidity in the market.

These developments mean new approaches are needed, and advances in technology and data science mean there will almost certainly be more use of trading platforms and exchanges: 68% of investors and 47% of managers expect them to gain market share (Figure 11), compared with only 10% and 16% five years ago. Both groups are also bullish on direct transactions. Technology-enabled platforms will have structural repercussions across the industry. They can, for example, make it easier to for smaller managers to compete for investors' attention, effectively levelling the playing field. Technology can also enable greater transparency and make it easier for investors to conduct due diligence. Both sides win.[14]

In-house technology use is also ramping up, thanks to the repurposing of travel and entertainment budgets. According to Kirkland & Ellis' Brian Bank, simplified scheduling means remote work has actually improved some aspects of the due diligence process for both managers and investors. Beyond sheer efficiency, he point out that this new model has encouraged "market mapping exercises as well as macro- and micro-level analysis. It is a function of ignorance not knowing what else is out there." Scott Baskind of Invesco adds, "The current environment has the potential to interrupt any GP's diligence efforts, but we also believe this is a time where you can derive meaningful benefits and relative edge from having a broad, fully integrated, private credit platform which incentivises information sharing and collaboration."

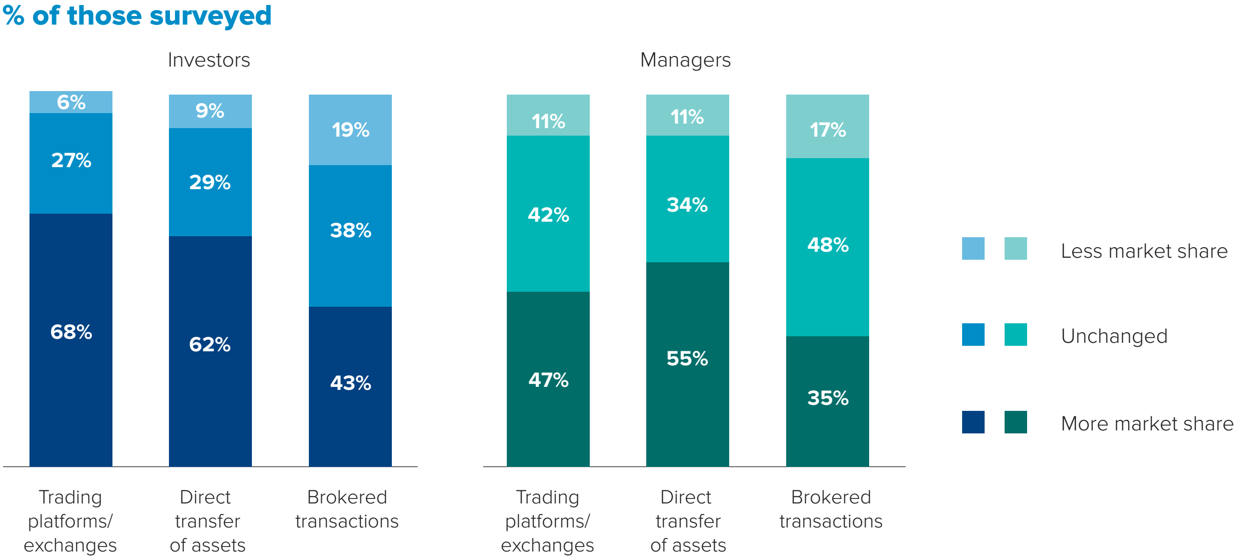
> **"Our global institutional investor base increasingly is demanding ESG to be fully integrated into private asset classes."**
>
> **Scott Baskind,**
> **Head of Global Private Credit, Invesco**

Pressing forward with packaged products

With the growing acknowledgement of a changing investor base, the need to expand packaging options is becoming clearer. There is still some scepticism around the future of private securities packaged as investment products such as mutual funds and ETFs, but approximately a third of all participants expect them to become more important features in the private market landscape (Figure 12). This is about the same level of conviction seen five years ago. What has changed more dramatically is the number of naysayers, which fell from 16% of all respondents six years ago to less than 10% today.

Tempered expectations may be a by-product of the mixed reception to liquid alts thus far. Despite the existence of 779 open-end funds categorised as alternative by Morningstar dating as far back as 1977, the median fund balance is still only US$57 million. Most of these funds exploded on the scene starting in 2005 as new and experienced managers

FIGURE 11. How do you think private market transactions will evolve over the next five years?



Source: 2020 SEI Private Market Liquidity Survey

alike crowded into the market. Yet there are currently only 41 managers who can claim more than US$1 billion of assets under management in alternative mutual funds or ETFs.[15]

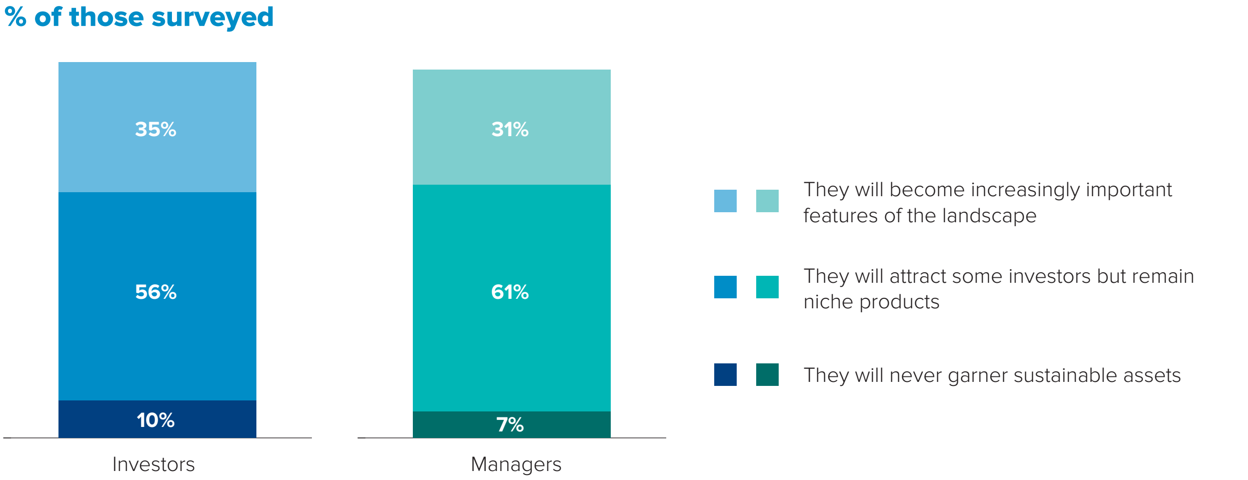
Tepid reception notwithstanding, proliferating liquid alts paved the way for this new cohort of private market funds, demonstrating that virtually any investment strategy can be packaged in novel and useful ways. Private markets, of course, present unique structural challenges that come with trying to package inherently illiquid investments in highly liquid vehicles. Regulatory hurdles set the bar even higher.

In a trickle that may preface an eventual flood, a few managers have chosen to seize the initiative and design private market products for the retail market. Much of their effort has focused on US '40 Act funds that can offer private market exposure with liquidity terms and low minimums more suited to individual investors. Exposure is often a mix of direct and secondary investments, sometimes with a strong emphasis on one or the other. Secondaries are valued in this market for the same reasons they are attracting more institutional investors: Later entry can eliminate the least desirable portion of the J-curve and ultimately permit timelier exits.

Despite operating under a common regulatory framework as US '40 Act funds, these products can differ substantially in the details. Some, like a fund launched by Partners Group back in 2009, are structured as tender-offer funds, which give the manager some degree of control over redemptions. Others are structured as interval funds, where the redemption process is prescribed and pricing may occur daily instead of monthly.[16]

Portfolio Advisors' Patrick Gerbracht lays out the case for the use of secondaries in retail products: "The private equity industry as a whole should be prudent and smart on expanding into the retail space. Secondaries, with their inherent attributes, allow retail investors to gain exposure to the alternatives space while avoiding the associated

FIGURE 12. What do you think of investment products that attempt to package exposure to private markets in more accessible vehicles, such as mutual funds, CITs, and ETFs?



Source: 2020 SEI Private Market Liquidity Survey

volatility with a significantly more concentrated portfolio like a traditional buyout or venture fund. The demand for increased alternative exposure is real and should serve as an enormous growth area for secondaries private equity in the years to come."

Mutual funds and ETFs will almost certainly play a key role in allowing mass affluent investors to access private markets either directly or via their advisors, but they may assume other forms as well. Offering steady flows and sticky assets, 401(k) plans are a plum prize for any manager targeting the retail market. As a heavily intermediated market, retirement plans will expect products to be adapted to their needs rather than the other way around. As a result, private market strategies may need to be packaged in CITs and embedded in target date funds (TDF) to succeed.

Is there a role for decentralised finance?

Exchanges or marketplaces for private equity and debt are relatively new concepts that rely heavily on technology for successful implementation. Still, they are modelled on well-established models for securities exchanges that date back centuries. More radical disruption could be around the corner, as a rapidly growing blockchain-based ecosystem awaits to facilitate trading and investing in a novel way.

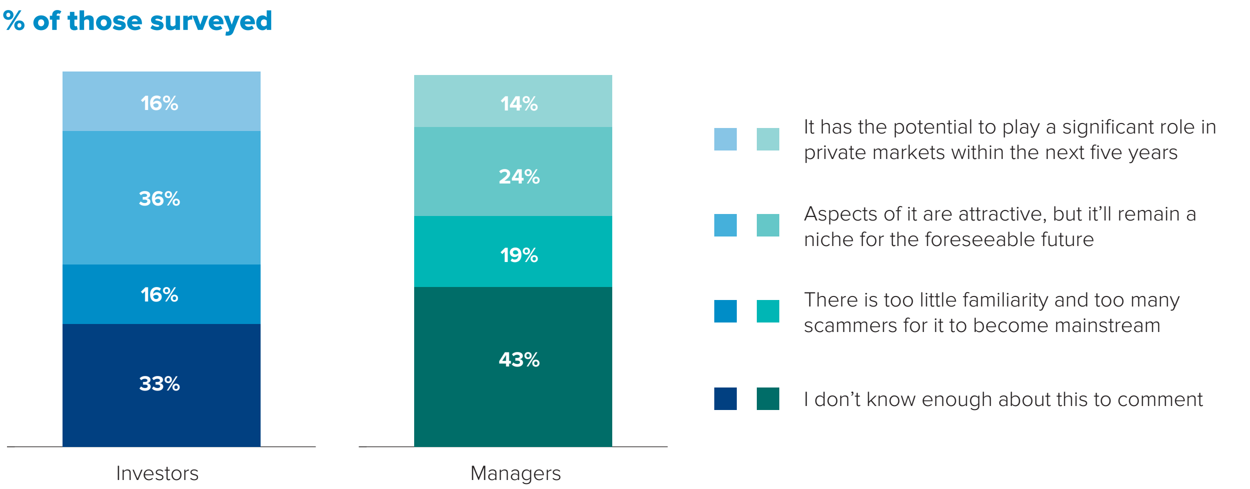
On-chain securitisation aims to revolutionise how private markets are traded.

Distributed ledger technology offers the promise of doing things very differently than the past. Even as many remain fixated on the gyrations of cryptocurrency prices, Ethereum-based decentralised finance—colloquially known as DeFi—is quietly flourishing. Tokens and protocols have mushroomed, thanks in no small part to the built-in security and simplicity allowed by embedded smart contracts. Most of this ecosystem is entirely digital and linking it to real-world assets via tokenisation is still a small part of the overall picture. It is not even clear that existing DeFi protocols will ultimately survive. In the meantime, however, they are collectively demonstrating an effective proof of concept.

Existing users or boosters of DeFi may be bullish on this model, but the private market managers and investors in our survey are more circumspect. Only 14% of managers expect tokenised assets to be traded in any meaningful way using distributed ledger technology within the next five years (Figure 13). Investors are more optimistic than managers, but most expect it to remain a fringe activity.

Will it ever amount to more? Thanks to multi-million-dollar sums being paid for sometimes questionable digital artwork, everyone is now familiar with non-fungible tokens (NFTs). Less commonly known is the fact that NFTs can be linked to physical assets such as oil paintings. This simple idea shines a light on a parallel ecosystem that has largely gone unheralded, where on-chain securitisation aims to revolutionise how private markets are traded. Tokeny, which claims to be "driving liquidity in private markets," confidently states that any financial asset can be tokenised. The company articulates use cases for private equity, debt, and real estate while promoting their platform as a way to "issue, manage, and transfer private market securities on a hyper-efficient infrastructure."[17] The jury is still out on the near-term prospects of DeFi and tokenisation, but given the potential for radical disruption, managers and investors will want to monitor developments in this area.

FIGURE 13. What is your view on the trading of tokenised assets using distributed ledger technology?



Source: 2020 SEI Private Market Liquidity Survey

HOW CAN ASSET MANAGERS ADAPT?

Even as the details are being ironed out, there is little doubt that private markets are evolving before our eyes as broader access and greater liquidity create a virtuous cycle. The potential market is huge. The overall size of the retail market is on par with institutional, but most retail investors have little or no existing exposure to alternatives. The same could have been said about the institutional market until recently: Allocations to alternative assets by US state pension funds rose to 19.1% in 2019 from only 5.6% in 2001.[18] Even a paltry 10% of the US 401(k) market would mean US$670 billion of new assets.[19]

A carefully curated roster of partners will be vital in ensuring the expertise and tools necessary to compete effectively.

Managers will need to adapt if they wish to exploit this emerging paradigm. Product design is one area of opportunity, since standardisation has yet to happen. The realities of retail distribution will be eye-opening for any GPs without any experience in that world. "Build it and they will come" is rarely successful. Even with pent-up demand, managers will need to justify their fees to retirement plans more accustomed to inexpensive passive strategies.[20] Successfully penetrating new markets means that education, data gathering, and analytics are paramount. Familiarity helps: "One of our key strategic priorities is to expand access to the private markets to newer groups of investors," says Drew Schardt, a Hamilton Lane managing director and Private Assets Fund investment committee member. "So we created (a) product to give the HNW, mass affluent, individual investors exposure to the asset class in a way that is unique and almost akin to how they're used to investing in other asset classes."[21]

Even asset managers choosing not to roll the dice with unproven investment vehicles will need to get accustomed to a more transparent operating environment. Investing in private markets will be less about who knows who, and more about ROI, fees, transparency, access, investor experience, and other factors that have determined success in the rest of the industry for decades. While diversifying their client base and revenue streams, managers will also need to get comfortable with fee erosion and avoid product cannibalisation. Greater access, transparency, and involvement by firms such as Vanguard mean inevitable pressure on fees. This is the cost of growth.

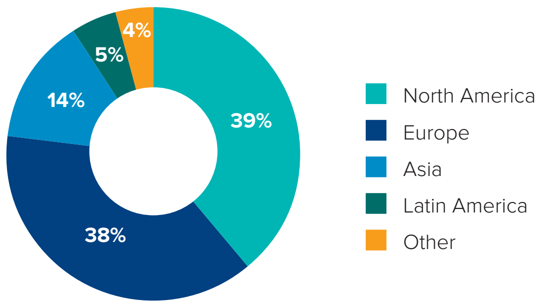
To shield (and potentially enhance) the margins to which they have become accustomed, managers will want to proactively address operational issues. Existing operating platforms may not be up to the task. Valuation methodologies, process transparency, regulatory compliance, reporting frequency, and other tasks will all need to be revisited and revamped. It is a daunting prospect, which makes the growing ecosystem of technology vendors and service providers a welcome sight for managers wary of change. Managers must carefully curate a roster of partners to ensure they have the expertise and tools necessary to compete effectively. Those planning to sell their expertise via different distribution channels will want to make a point of finding partners with expertise and experience in building bridges between the world of alternative investments and retail markets. No one can go it alone. The right partnerships should serve as springboards for anybody intent on succeeding in the soon-to-be transfigured world of private markets.

ABOUT THE SURVEY

SEI partnered with Preqin and ANZU Research to survey 407 private market professionals during Q4 2020 to gain their perspectives on the opportunities and threats associated with ongoing change in their industry. Specific areas of focus included democratisation of alternative asset classes, product development for retail investors, the role of intermediaries, and the use of secondaries. Survey responses from GPs slightly outnumbered those from LPs, 52% to 48%.

The survey was conducted globally, with 39% of respondents self-identifying as coming from North America, an almost identical number from Europe, 14% from Asia, and the remainder from Latin America, Australia, the Middle East, and Africa (Figure 14).

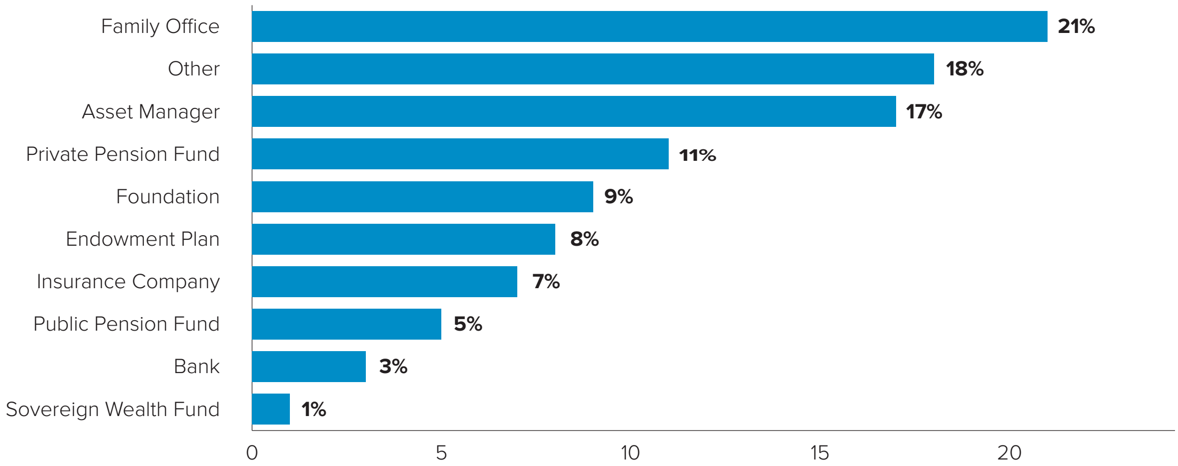
FIGURE 14. Survey respondents by geography



Source: 2020 SEI Private Market Liquidity Survey

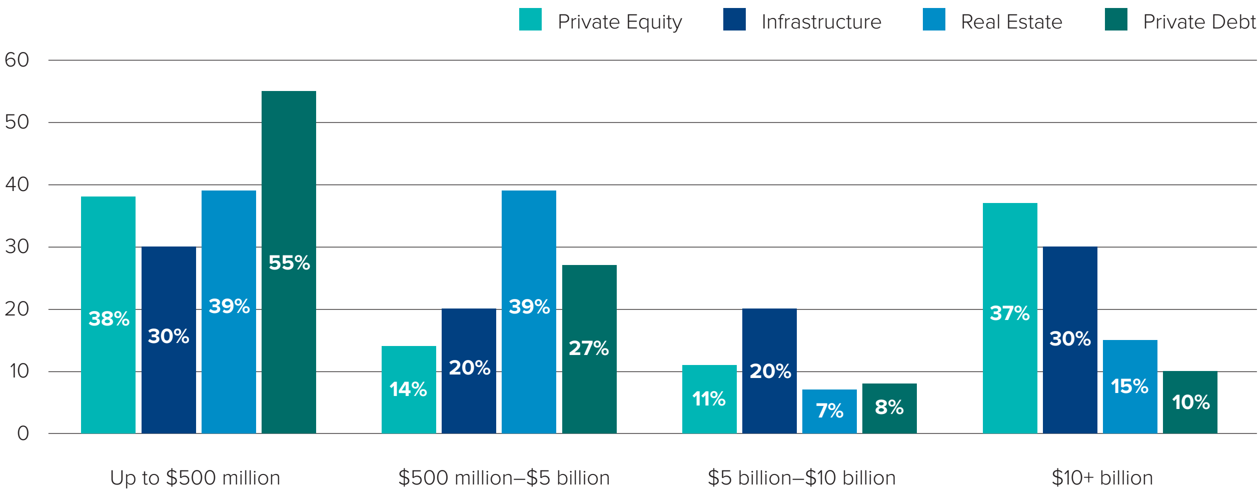
A wide variety of LPs took part. Family offices accounted for 21% of all investor responses, followed by asset managers, at 17%. Private and public pension funds collectively accounted for a similar proportion of responses. Foundations and endowments also contributed in meaningful numbers (Figure 15).

FIGURE 15. Investors/LPs by type



Source: 2020 SEI Private Market Liquidity Survey

FIGURE 16. Managers/GPs by type (AUM in US $)



Source: 2020 SEI Private Market Liquidity Survey

GPs in the survey include managers of private equity, private credit, real estate, and infrastructure. Participating PE managers tend to be either very large (US$10+ billion AUM) or relatively small (<US$500 million). Real estate managers exhibited a similar—albeit less pronounced—barbell shape.

Infrastructure managers can be found in every cohort but are more likely to fall at the smaller end of the scale (Figure 16). With more than half of them managing less than US$500 million, private debt respondents are the most likely to represent smaller firms.

Endnotes

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